September 17, 2009

Subway's $5 deal a hard habit to break

By Lisa Baertlein - Analysis

LOS ANGELES (Reuters) - Subway's $5, foot-long sandwich deal has given birth to the biggest restaurant pricing trend since McDonald's Corp's (MCD.N) 2002 Dollar Menu debut, but some to wonder whether it will make it harder to break diners' discount habit.

Since Subway's introduced the deal in early 2008, "$5 has emerged as the second most important price point" in the fast-food industry after $1, said Telsey Advisory Group analyst Tom Forte.

"I would not be surprised if Subway was outperforming many of its peers" due to the promotion, he said.

Privately held Subway, which does not disclose sales figures, has 22,000 outlets in the United States compared with about 14,000 for McDonald's, and is seen as a major force in the fast-food segment.

Jeff Moody, chief executive of the Subway Franchise Advertising Fund Trust, told Reuters that as fast-food restaurants saw same-store sales slip into negative territory in the last few months, Subway has seen less deterioration due in part to the promotion.

"We can correlate our sales to unemployment," said Moody.

Analysts expect future gains would not come as easily. Subway is lapping year-ago figures that benefited from the $5 deal. Beyond that, joblessness is forecast to continue climbing and rivals like Yum Brands Inc's (YUM.N) and Wendy's/Arby's Group Inc (WEN.N) have stepped up competition.

Stifel Nicolaus analyst Steve West said the $5 deal helped Subway steal traffic from quick-serve hamburger chains, but he predicted that the company could have trouble weaning diners from the $5 sandwiches after the economy rebounds.

They've "trained the customer to eat $5 foot-longs," West said.

DEALS, DEALS EVERYWHERE

The Subway promotion spurred many copycat deals. KFC and Arby's have promoted $5 meal deals while Subway rival Quiznos has attempted to undercut the company with a $4 sandwich special.

Elsewhere, McDonald's and Burger King (BKC.N) are offering two-for-one sandwich deals in the $3 and $4 range, depending on the market.

Such discounts can pressure restaurant operators, who pay their parent companies fees based on overall sales.

When prices for ingredients like meat and cheese are low, franchisees have wiggle room to offer discounts. The promotions attract customers, who may then splurge on a more profitable soda with their inexpensive sandwich.

But when food prices rise, as they tend to do over time or when inflation strikes, franchisee profits get squeezed.

Fast-food restaurants had been more insulated than other segments of the restaurant industry due to their relatively lower prices. But as companies continue lay offs, they too are feeling the pinch.

The nation's jobless rate hit 9.7 percent in August and is expected to head higher.

California already has double-digit unemployment and the UCLA Anderson Forecast group expects the Golden State's jobless rate to remain above 10 percent until late 2011.

Overall visits to fast-food restaurants fell 2 percent in the three-month period ended June, versus with the same period in 2008, NPD restaurant industry analyst Bonnie Riggs said.

Fast-food's traffic decline was mild compared with the 3 percent fall in the casual dining segment that includes names like Chili's (EAT.N), Applebee's (DIN.N) and Red Lobster (DRI.N). Visits to mid-scale family dining chains that include brands like Denny's (DENN.O) and IHOP were off 6 percent while fine dining dropped 12 percent, Riggs said.

"It's not a pretty picture," said Riggs, who added that the restaurant industry is the weakest it has been in nearly three decades.